

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Review of the Commission's Rules Regarding)	WC Docket No. 03-173
the Pricing of Unbundled Network Elements)	
and the Resale of Service by Incumbent Local)	
Exchange Carriers)	
)	

COMMENTS OF ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.

ALASKA COMMUNICATIONS SYSTEMS
GROUP, INC.

Leonard A. Steinberg
General Counsel
ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
ACS OF ANCHORAGE, INC.
600 Telephone Avenue
Anchorage, AK 99503
(907) 297-3000

Karen Brinkmann
Elizabeth R. Park
LATHAM & WATKINS LLP
555 Eleventh Street, N.W.
Suite 1000
Washington, D.C. 20004-1304
(202) 637-2200

*Counsel for Alaska Communications
Systems Group, Inc.*

December 16, 2003

TABLE OF CONTENTS

	<u>Page</u>
I. SUMMARY	1
II. BACKGROUND	4
III. Goals of UNE Pricing – TELRIC NPRM § IV.A.1	9
A. TELRIC-Based Rates Should Encourage Facilities-Based Investment	9
B. UNE Rates Set By The RCA In ACS’s Markets Send Inappropriate Entry Signals	11
C. State Regulators Should Periodically Evaluate Market Conditions And Adjust UNE Rates As Necessary	13
D. Review of Confiscatory Rates	15
IV. Universal Service Issues – TELRIC NPRM § IV.A.3	18
A. Use of USF Inputs Has Had Detrimental Effects On ACS’s Markets	18
B. Impact of UNE Rates and USF Support	19
V. Network Assumptions Should Relate to the Carrier Whose UNEs Are Being Priced And The Market – TELRIC NPRM § IV.B.	21
A. General Theory – TELRIC NPRM § IV.B.1	21
1. Forward-Looking Costs Should Be Based On A Hypothetical Network, Not A Hypothetical Carrier	21
2. TELRIC Pricing Should Reflect Attributes of the ILEC And The Market In Which It Serves	23
3. The Hypothetical Network Must Reflect A Mix Of Old And New Technology	27
4. Decisions Made By CLECs in the Market	28
B. Definition of Efficiency	30
C. TELRIC Based Rates May Be Higher Or Lower Than Rates Based On Embedded Cost	32
D. Minimization of Discovery and Production Burdens	33
VI. Specific Pricing Inputs – TELRIC NPRM § IV.B.2	35
A. Network Routing and Construction – TELRIC NPRM § IV.B.2.a	35
B. Structure Sharing – TELRIC NPRM § IV.B.2.c	37
C. Fill Factors – TELRIC NPRM § IV.B.2.d	38
D. Switch Discounts – TELRIC NPRM § IV.B.2.e	40
VII. Other Input Assumptions Should Relate To Competitive Reality In The Market	41
A. Cost of Capital – TELRIC NPRM § IV.C.	41

B.	Depreciation Expense – TELRIC NPRM § IV.D.	43
C.	Expense Factors – TELRIC NPRM § IV.E.	45
D.	Non-Recurring Charges – TELRIC NPRM § IV.F.	47
VIII.	Rate Changes Over Time – TELRIC NPRM § IV.I.	48
IX.	Resale Pricing – TELRIC NPRM § V.....	50
X.	Implementation Issues – TELRIC NPRM § VII.....	51
XI.	Conclusion.....	53

TABLE OF EXHIBITS

	<u>Exhibit</u>
Prefiled Opposition Testimony of David C. Blessing on Behalf of ACS of Anchorage.....	A
Prefiled Reply Testimony of David C. Blessing on Behalf of ACS of Anchorage.....	B
Prefiled Direct Testimony of Steven D. Cinelli, P.E. on Behalf of ACS of Anchorage	C
Prefiled Reply Testimony of Steven D. Cinelli on Behalf of ACS of Anchorage	D
Prefiled Direct Testimony of Heather M. Eldred on Behalf of ACS of Anchorage	E
Michael Majoros Cross-Examination from Public Hearing November 10, 2003	F
Prefiled Direct Testimony of Thomas R. Meade on Behalf of ACS of Anchorage.....	G
Prefiled Direct Testimony of Dr. Howard Shelanski on Behalf of ACS of Anchorage	H
Prefiled Reply Testimony of Dr. Howard Shelanski on Behalf of ACS of Anchorage	I
Dr. Howard Shelanski Cross-Examination from Public Hearing November 3, 2003	J
Prefiled Direct Testimony of Kenneth L. Sprain on Behalf of ACS of Anchorage.....	K
Dana Tindall Cross-Examination from Public Hearing November 6, 2003	L
Prefiled Opposition Testimony of William J. Wilks on Behalf of ACS of Anchorage.....	M
Prefiled Reply Testimony of William J. Wilks on Behalf of ACS of Anchorage.....	N

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Review of the Commission's Rules Regarding)	WC Docket No. 03-173
the Pricing of Unbundled Network Elements)	
and the Resale of Service by Incumbent Local)	
Exchange Carriers)	
)	

COMMENTS OF ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.

Alaska Communications Systems Group, Inc. ("ACS"), on behalf of the ACS local exchange carriers ("LECs"),¹ hereby submits comments in response to the Commission's Notice of Proposed Rulemaking to review the current pricing rules for unbundled network elements ("UNEs"), which are based on the Total Element Long Run Incremental Cost ("TELRIC") methodology.² ACS urges the Commission to provide more specific guidance to state commissions on how to implement TELRIC in a manner that promotes the goals of Section 251 of the Communications Act of 1934, as amended (the "Act").³

I. SUMMARY

In these comments, ACS urges the Commission to adopt guidelines that will assist state commissions to establish TELRIC rates that are based on reasonable assumptions about forward-looking costs for the specific ILEC and market for which UNE rates are being developed. Properly developed UNE rates will promote the goals of TELRIC: to send efficient entry and investment signals to competitors by allowing ILECs an opportunity to recover their

¹ ACS of Anchorage, Inc., ACS of Fairbanks, Inc., ACS of Alaska, Inc., and ACS of the Northland, Inc. are wholly-owned subsidiaries of Alaska Communications Systems Group, Inc.

² *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, Notice of Proposed Rulemaking, FCC 03-224 (rel. Sept. 15, 2003) ("*TELRIC NPRM*").

³ *See* 47 U.S.C. § 251.

forward-looking costs. The circumstances in ACS's markets illustrate that rates set unreasonably low will result in inefficient entry by competitors and will deter both ILECs and CLECs from investing in network facilities.

In response to the Commission's inquiry regarding the ability of ILECs to recover their costs and the possibility that TELRIC pricing is producing confiscatory rates, ACS asks that the Commission clarify its procedures for seeking review of rates that may be confiscatory. ACS has tried without success to obtain such review for UNE rates in Alaska, some of which were based on nationally-averaged default inputs for universal service funding purposes instead of ACS's actual costs. In the meantime, ACS's primary competitor General Communication Inc. ("GCI"), has enjoyed below-cost UNE rates while collecting universal service support based, not on these low UNE rates, but rather on ACS's own costs. The combined effect of these two components is that GCI receives a windfall gain because it is not using support for the purposes intended under the Act.

ACS asks the Commission to make clear that forward-looking costs should be based on network assumptions that relate specifically to the ILEC whose UNEs are being priced. The TELRIC methodology is based on a hypothetical network model, not a hypothetical carrier. Thus, it is the design of the network, including the type of components and the technology of the equipment, that is hypothetical, not the cost of constructing that forward-looking design. With respect to network design, state commissions should be required to consider the real-world attributes of the ILEC and the geographic market in which the network is located. With respect to costs of construction, local factors in the market and attributes of the particular ILEC should be accounted for in the determination of appropriate cost inputs. Further, an efficient carrier's network must reflect a mix of old and new technologies, rather than an instantaneous

replacement of the entire network. ACS proposes that the ILEC should be presumed to be efficient after it has been effectively competing for a period of three years.

In these comments, ACS recommends guidelines for states to use in determining forward-looking cost inputs that are based on realistic market assumptions:

- Cost of Capital: The Commission should establish a floor for a carrier's forward-looking cost of capital that is based on the currently authorized federal rate of return of 11.25%, and graduated upward to account for the level of facilities-based competition anticipated in the market. State commissions should be directed not to use a forward-looking cost of capital that is below this graduated floor.
- Depreciation Expense: The Commission should reiterate its clarification in the *Triennial Review Order* that state commissions should establish UNE rates based on an accelerated depreciation of assets to reflect the anticipated decline in value and to allow the carrier to compete with competitors purchasing new, lower-priced equipment in later years. The Commission should provide more explicit guidance on how to apply accelerated depreciation in a competitive environment. Further, the Commission should mandate the use of shorter asset lives to account for competitive risks in a forward-looking environment.
- Expense Factors: Operations and maintenance costs should not be tied to construction costs because efficiencies in construction do not necessarily correspond to decreased operations and maintenance costs. Further, the Commission should require forward-looking corporate operations expense to fall within a reasonable range above or below the cap on such expenses for universal service purposes, so that such costs will be reasonable for the ILEC in question.
- Non-Recurring Charges: Non-recurring charges should reflect the actual costs of the ILEC and should not assume network efficiencies that the ILEC cannot reasonably achieve using its current facilities. In markets with significant competition, the ILEC should be allowed to recover non-recurring charges over a shorter timeframe.

Through this specific guidance, state commissions will be better able to establish UNE rates that are appropriate for the market in question and to promote the goals of TELRIC pricing.

For UNE rates that are established based on the types of guidelines proposed by ACS in these comments, state commissions should be required to revisit these rates every three

years and make any necessary adjustments to ensure that the rates are sending appropriate market entry signals. For UNE rates based on less specific guidance, such as the TELRIC rules currently in place, state commissions should be required to revisit rates more frequently due to the excessive opportunity for such rates to have a confiscatory effect and the lack of procedures for review of confiscatory rates. Further, arbitrating parties should always be allowed to agree on a different time period for review of UNE rates.

II. BACKGROUND

The UNE rate setting process in Anchorage, Fairbanks and Juneau, have convinced ACS that the Commission must place limits on the states' discretion in applying TELRIC. In ACS's experience, the level of discretion under the current FCC rules essentially has opened the door to completely random ratemaking. States are neither bounded at the front end of the process by clear guidance from the FCC, nor subject to review at the back end of the process to ensure they reach a just and reasonable result. Consequently, in the November 3, 2003 arbitration hearing held by the Regulatory Commission of Alaska ("RCA") for Anchorage, the parties have proposed alleged TELRIC rates for UNE loops, supported by considerable expert evidence, that range from \$7 to \$25. The wide disparity in the arbitration positions of ACS and GCI, suggests that the current TELRIC rules are so vague that they are ineffective in developing economically rational rates. For instance, while ACS's proposed \$25 UNE loop rate for Anchorage was based on evidence of ACS's real-world costs, GCI's proposed UNE rate of \$7 was purportedly based on good faith estimates and expert testimony on what reasonable rates

should be; however, even GCI admitted that such testimony could support a wide range of rates, including the current rate of \$14.92, more than double the rate in GCI's good faith proposal.⁴

The vagaries of the current TELRIC rules also permit state commissions to use purely hypothetical cost inputs that in no way resemble any real-world costs in the market actually served by the ILECs. In Fairbanks, the RCA set UNE rates that were based on GCI's proposals using default-based input cost values from the FCC's "Synthesis Model." That model was developed and adopted in the context of universal service funding for purposes of establishing the relative cost characteristics of different carriers, based on nationally averaged costs for non-rural companies, excluding the costs of any Alaska ILECs.⁵ Despite the Commission's numerous statements that default cost inputs are inappropriate for use in the UNE ratemaking process, the RCA has used these non-rural USF inputs to develop UNE rates in Fairbanks, one of ACS's rural markets.⁶ Because the nationally-averaged cost inputs are significantly lower than actual costs in Alaska, the resulting UNE loop rate of \$19.19 in Fairbanks does not allow ACS to recover its costs. This rate also gives GCI a huge cost advantage over ACS, especially when combined with universal service support that is based on

⁴ Testimony of Dana Tindall on Behalf of General Communication Inc., Before the Regulatory Commission of Alaska, *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89, Public Hearing, Volume X at 849-50 (Nov. 6, 2003) ("Tindall Testimony").

⁵ *Federal-State Joint Board on Universal Service; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket No. 96-45, Fifth Report and Order, 13 FCC Rcd 21323 (1998) ("Platform Order"); *Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd 8776 (1997) ("Universal Service Report and Order").

⁶ *See Petitions by GCI Communication Corp. with PTI Communications of Alaska, Inc., Telephone Utilities of Alaska, Inc., Telephone Utilities of the Northland, Inc., under 47 U.S.C. §§ 251 and 252 for the Purpose of Instituting Local Exchange Competition*, U-99-141/142/143, Order 10, Order Approving Interconnection Agreement and Denying Request for Establishment of Interim and Refundable Rates (Reg. Comm. of Alaska, Oct. 5, 2000).

ACS's costs.⁷ As a result, GCI has been able to gain over 21 percent of the market since entering the Fairbanks, and 19 percent in Juneau.⁸

In Anchorage, the \$14.92 UNE loop rate was established entirely without regard to the TELRIC rules. The RCA has yet to establish forward-looking cost-based rates in Anchorage in a ratemaking proceeding that has been ongoing for the last seven years. The lack of guidance from the Commission on how to implement TELRIC has contributed to the RCA's adoption of UNE rates that are not based on any real costs in ACS's markets. As the Commission proposes in the *TELRIC NPRM*, UNE rates should be based on real costs for the market in which they apply.⁹ Forward-looking costs can be reasonably related to actual costs without constituting embedded costs, and may be lower *or higher* than embedded costs.

ACS believes the rates in Anchorage are also unreasonably low, which has contributed to ACS's loss of approximately 50 percent of its market share in this market since

⁷ See Comments of ACS of Fairbanks, Inc., *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 (filed May 5, 2003).

⁸ Comments of General Communication, Inc., *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 at 7 (filed May 5, 2003). ACS believes that GCI's market share in Fairbanks has grown close to about 24% and in Juneau to about 21% since GCI filed those comments.

⁹ TELRIC NPRM at ¶¶ 4, 50, 52; *see also*, TELRIC NPRM, Separate Statement of Chairman Powell ("It is my hope that at the end of this proceeding the market will benefit from a methodology that is less theoretically freewheeling. . . . I believe that an approach grounded in the real-world attributes of the incumbent's network would address claims that our TELRIC rules currently distort a competitor's decision whether to invest in new facilities or to lease an incumbent's existing facilities."); Separate Statement of Commissioner Abernathy ("I believe that most carriers agree that the UNE pricing standard should be constrained by reality, as opposed to being purely hypothetical."); Separate Statement of Commissioner Martin ("our unbundled network element pricing methodology, while forward-looking, should be based upon the incumbent local exchange carrier's actual network rather than the totally hypothetical assumptions contained in a cost proxy model"); Commissioner Adelstein ("I nonetheless joint in a limited tentative conclusion that our TELRIC rules should more closely account for certain real-world factors – namely, the routing and topography of the incumbent LEC's network.").

1996.¹⁰ In a recent RCA decision, a commissioner noted in dissent that “Anchorage’s level of competition in the retail telephone market exceeds that of every other city in the Lower 48 [states] by nearly 20 points.”¹¹ The continued regulation of UNE rates in the face of competition and the years of below-cost rates have taken a toll on facilities-based competition in the market. GCI has its own switching capability and has constructed its own lines in two subdivisions in Anchorage. Despite GCI’s significant investment in switching and transport capability, GCI has recently expressed interest in leasing below-cost UNE-P from ACS.¹² Moreover, a GCI official has even admitted in the Anchorage UNE rate hearings, that GCI would not proceed with its plans to use its own facilities if the RCA adopted GCI’s proposed UNE loop rate of \$7.¹³ In recent years, GCI has promised to serve its customers on its own capable telephony platform, but GCI has repeatedly delayed the deployment cable telephony to take advantage of lower cost UNEs.

¹⁰ *Investigation of the Local Exchange Revenue-Requirement, Depreciation, Cost-of-Service, Rate Design Studies, and Tariff Rate Revisions Designated as TA429-120, TA431-120, and TA457-120 Filed by ACS of Anchorage, Inc.*, Order Granting Reconsideration, in Part; Granting Confidentiality; Making Rates Interim But Not Refundable; Subsuming Issues Into Docket U-01-34, Amending Docket Title; Affirming Electronic Ruling Extending Filing Deadline; and Closing Docket U-03-99, U-01-34 (27), Dissenting Statement of Commissioner Kate Giard at 1 (Reg. Comm. of Alaska, Dec. 8, 2003) (“RCA Reconsideration Order”). Of the approximately 50 percent market share lost, 45 percent of the loss is attributable to GCI, while the remaining loss is attributable to AT&T.

¹¹ *Id.*

¹² Prefiled Reply Testimony of David C. Blessing on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89 at 22 (filed Aug. 23, 2003) (“Blessing Prefiled Reply Testimony”).

¹³ Tindall Testimony at 850.

In the *Local Competition First Report and Order*, the Commission recognized that TELRIC prices should not be based entirely on a hypothetical carrier.¹⁴ Instead, the Commission determined that forward-looking costs reflect the costs of a hypothetical network taking into account the actual location of the carrier's wire centers.¹⁵ However, the Commission never required states to assume that the hypothetical network would be put in place over night.¹⁶ Further, the Supreme Court in *Verizon v. FCC* found that the TELRIC methodology could take into account imperfections in competition and certain inefficiencies inherent in the market.¹⁷ Thus, the TELRIC rules already contemplate certain attributes of the ILEC's network. In these comments, ACS does not ask the Commission to change the overall thrust of its TELRIC rules, or depart from forward-looking pricing principles. ACS only requests that the Commission provide guidance that will direct state commissions to establish forward-looking rates that have some basis in reality, so rates can promote economically sound investment decisions by both CLECs and ILECs.

¹⁴ *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499 at ¶ 685 (1996) (subsequent history omitted) ("*Local Competition First Report and Order*").

¹⁵ *Id.*; see also, 47 C.F.R. § 51.505(b)(1).

¹⁶ See TELRIC NPRM at ¶ 50; see also, *Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration*, CC Docket No. 00-218, Memorandum Opinion and Order, DA 03-2738 at ¶¶ 42, 55-56 (rel. Aug. 29, 2003) ("*Verizon Virginia Arbitration Order*") (The Commission adopted Verizon's proposed cost study for switching and transport. Verizon's cost study used as a starting point its existing network configuration and adjusted technology assumptions for this network to represent the mix of technologies that Verizon deploys today and applied forward-looking adjustments to its existing network based on current engineering and deployment guidelines.).

¹⁷ *Verizon Communications, Inc. v. FCC*, 533 U.S. 467 at 504 (2002).

III. GOALS OF UNE PRICING – TELRIC NPRM § IV.A.1

A. TELRIC-Based Rates Should Encourage Facilities-Based Investment

In the TELRIC NPRM, the Commission describes the two objectives of UNE pricing as distinct goals: “First, UNE prices should be set in a manner that sends efficient entry and investment signals to all competitors. Second, UNE prices should provide incumbent LECs an opportunity to recover the forward-looking costs of providing UNEs.”¹⁸ ACS disagrees that these two goals are necessarily distinct. If UNE prices allow the ILEC an opportunity to recover its forward-looking costs, then by definition, such prices are sending efficient entry and investment signals to competitors. If prices are set correctly, ILECs will continue to invest in the network, and efficient CLECs will still enter the market and, over time, will construct alternative facilities.¹⁹ Alternatively, if the prices do not allow the ILEC an opportunity to recover its costs, then inefficient CLECs may be improperly encouraged to enter the market, and there will be no incentive for any carrier to invest in network facilities.

The Commission has long recognized the importance of promoting facilities-based investment and has acknowledged that the goal of facilities investment cannot be achieved if UNE prices are too low. In the *Local Competition First Report and Order*, the Commission stated the importance of facilities-based competition, citing facilities-based competition as one of the primary purposes of TELRIC.²⁰ Since the release of that Order, the Commission has repeatedly emphasized its commitment to promoting facilities-based competition.²¹ The

¹⁸ TELRIC NPRM at ¶ 38.

¹⁹ *Id.* at ¶ 2; *Local Competition First Report and Order* at ¶ 672.

²⁰ *Local Competition First Report and Order* at ¶ 685.

²¹ *See, e.g., Review of Commission Consideration of Applications Under the Cable Landing License Act*, Report and Order, 16 FCC Rcd 22165 (2001) (adopting streamlined procedures for processing applications for submarine cable landing licenses designed to facilitate the expansion of capacity and

Commission has stated that it is committed to “ensuring that facilities-based competitors have the incentive and ability to invest in alternative infrastructure and innovating technologies, while at the same time, ensuring that incumbents retain similar incentives and capabilities.”²² The Commission now has the opportunity to direct state commissions that have not set UNE prices at appropriate levels, to adopt realistic cost assumptions and set economically rational rates that will encourage efficient facilities investment.

TELRIC rates were intended to allow ILECs to recover their forward-looking costs, not to allow CLECs to obtain a subsidy or a windfall gain. However, the latter occurs when UNE rates are established in a manner that does not comport with the goals of TELRIC. Access to UNE rates that have been set based on below-market costs in ACS’s markets have presented GCI with the option of leasing UNEs at low rates and deferring the use of its own facilities. As an illustration, although GCI has its own switching capability, and never ordered switching UNE access in Anchorage before, GCI recently has sought lower switching prices in order to make the unbundled platform (“UNE-P”) a more attractive option so that it may replace its own switches with UNE-P.²³ The value of a “buy vs. build” option, in addition to any

facilities-based competition; ¶ 1); *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking, FCC 01-304 (rel. Nov. 8, 2001) (“By rationalizing the rate structure for recovery of interstate-allocated loop costs, we are fostering competition for residential subscribers in rural areas by facilities-based carriers.” ¶ 11); *Application of Verizon Pennsylvania Inc., Verizon Long Distance, Verizon Enterprise Solutions, Verizon Global Networks Inc., and Verizon Select Services Inc. for Authorization To Provide In-Region, InterLATA Services in Pennsylvania*, CC Docket No. 01-138, Memorandum Opinion and Order, FCC 01-269 (rel. Sept. 19, 2001) (evaluating facilities-based competition in the market in Pennsylvania is part of the determination; ¶ 124).

²² *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Fourth Report and Order, 16 FCC Rcd 15435 ¶ 14 (2001).

²³ See Prefiled Reply Testimony of David C. Blessing on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting*

forward-looking costs that the ILEC cannot recover, are effectively a subsidy to the CLEC.²⁴ And subsidizing the CLEC's costs distorts entry decisions and encourages uneconomic entry. The TELRIC guidelines that ACS proposes in these comments are aimed at maintaining the goals of facilities-based competition and preventing the creation of improper investment incentives.

B. UNE Rates Set By The RCA In ACS's Markets Send Inappropriate Entry Signals

Unfortunately, in ACS's markets, the RCA has applied the TELRIC rules in a manner that is contrary to the goal of promoting facilities investment. In Anchorage, the RCA has never implemented TELRIC-based rates, despite ACS's ongoing efforts since January 2000 to have its 1996 interconnection agreement superceded by TELRIC-compliant rates.²⁵ As a result, the current UNE loop rate of \$14.92 in Anchorage is in no way based on ACS's costs and is insufficient to allow ACS to continue investing in its network.²⁶ ACS of Anchorage, Inc. now has a rate of return of approximately ½%, which has forced the company to reduce amounts

Local Exchange Competition, U-96-89 at 22 (filed Aug. 23, 2003) ("Blessing Prefiled Reply Testimony").

²⁴ Testimony of Howard A. Shelanski on Behalf of ACS of Anchorage, Inc., Before the Regulatory Commission of Alaska, *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89, Public Hearing, Volume VII at 227-8 (Nov. 3, 2003) ("Shelanski Oral Testimony").

²⁵ See *Order Granting Motion to Establish Forward-Looking Economic Cost Models and Methodologies; Denying Motion for Consolidation; and Denying Request for Hearing*, U-96-89(13) (Reg. Comm. of Alaska Mar. 6, 2000). Although ACS was successful in obtaining a slight increase in the UNE loop rate in Anchorage in 2001, the RCA is not expected to complete its forward-looking cost proceedings and approve a new interconnection agreement until February 2004 or later. See *Order Establishing Interim and Refundable Unbundled Network Element Loop Rate and Affirming Oral Ruling*, U-96-89 (23) (Reg. Comm. of Alaska, Oct. 25, 2001).

²⁶ The \$14.92 UNE loop rate is based on rates that were set prior to the adoption of the Telecommunications Act of 1996.

allocable to maintenance of facilities, customer service levels and capital spending.²⁷ Further, GCI has captured approximately 45 percent of the local exchange market in Anchorage,²⁸ in large part due to the artificially low UNE rates.

Further, unreasonably low UNE prices have forestalled the development of facilities-based competition in Anchorage. Despite GCI's significant investment in switching and transport capability in Anchorage, through which GCI has gained approximately 45 percent market share, GCI has recently expressed interest in obtaining access to UNE-P from ACS.²⁹ Moreover, GCI recently admitted in the Anchorage UNE rate arbitration, that GCI would reconsider its plans to deploy its own facilities if the RCA approved the UNE loop rate of \$7 that GCI has proposed.³⁰

In the rural Fairbanks and Juneau markets, the RCA adopted rates based on an entirely hypothetical efficient carrier standard, a standard which the Commission clearly rejected in the *Local Competition First Report and Order*.³¹ The RCA established these UNE rates based primarily on nationally-averaged costs for non-rural companies. Thus, these rates reflect neither

²⁷ Prefiled Direct Testimony of Kenneth L. Sprain on Behalf of ACS of Anchorage, *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-95-89 at 6 (filed Aug. 29, 2003). GCI's proposed solution to ACS's inability to invest in the network is to argue that the RCA has the authority to force ACS to make investments in the network. This is contrary to the deregulatory environment that the Act is aimed at achieving.

²⁸ *Ex Parte* Presentation Notice Submitted by General Communication, Inc. at 5, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket Nos. 01-338, 96-98, 98-147, 01-318, 98-56, 98-141 (filed Jan. 28, 2003); Prefiled Direct Testimony of Thomas R. Meade on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-95-89 at 3 (filed Aug. 29, 2003) ("Meade Prefiled Direct Testimony").

²⁹ Blessing Prefiled Reply Testimony at 22.

³⁰ Tindall Testimony at 850.

³¹ *Local Competition First Report and Order* at ¶ 683.

ACS's costs, nor any costs that can be found in Alaska. These unreasonably low rates have resulted in an artificially high level of competition. Since the RCA terminated the rural exemptions in these markets, GCI has garnered over 21 percent of the Fairbanks local exchange market and 19 percent of the Juneau market.³²

C. State Regulators Should Periodically Evaluate Market Conditions And Adjust UNE Rates As Necessary

Because of the critical role of the TELRIC rates in signaling economic entry by competitors and in enabling ILECs to recover their costs, UNE rates and other interconnection terms, such as was the case in Anchorage, state commissions should be required periodically to evaluate market conditions that evolve over time. ACS proposes that states revisit UNE rates every three years to determine whether prices are sending appropriate signals to the market. As ACS discusses further in these comments, real-world costs in a particular market, or other benchmarks established by the Commission, should streamline state commission UNE rate determinations. Therefore, reevaluation of rates every three years is reasonable provided that the Commission adopt the types of specific guidelines that ACS proposes in these comments. Under the current TELRIC rules, a two-year review period is more appropriate because of the greater potential for rates that are not based on the ILEC's costs to have a confiscatory effect. The Commission should also allow review subject to different time periods that are agreed upon by the parties to the UNE rate arbitration.

As part of such review, state commissions should be directed to evaluate the gains in market share by CLECs during the period in question and the market power of CLECs relative to the ILEC. In its evaluation, the regulator should assume rational behavior by competitors -- if

³² Comments of General Communication, Inc., *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 at 7 (filed May 5, 2003). ACS believes that GCI's market share in Fairbanks has grown close to about 24% and in Juneau to about 21% since GCI filed those comments.

prices are too low, even efficient competitors will delay deployment of competing facilities. In Anchorage, for example, regulators should take into account the mature nature of competition in the market, the considerable resources of the UNE-based competitor, and its announced intention to deploy its own facilities. Further, it should be relevant that in Anchorage, ACS has substantially curtailed capital expenditures to improve or upgrade the network due to non-remunerative returns and the low probability of recouping this investment. When both ILECs and CLECs are deterred from investing in facilities, state commissions should be required to adjust UNE rates. Although forward-looking costs are inherently uncertain, states should evaluate the market and adjust rates to reflect changes in known costs and to adjust assumptions for forward-looking trends. Failure to adjust UNE prices for changes in market conditions will result in inappropriate market incentives.

In addition, ACS requests that the Commission clarify that the same nine-month period for completing the arbitration of initial interconnection agreements, as provided in Section 252(b)(4) of the Act,³³ also applies to the arbitration of any subsequent agreement. In Anchorage, the RCA has never established forward-looking cost-based rates, even though a ratemaking proceeding has been ongoing for the last seven years. Further, even though ACS formally petitioned the RCA for new rates in January 2000, the RCA has yet to issue a decision on that request. In order to avoid such results, the Commission should explicitly mandate that the arbitration of subsequent interconnection agreements be resolved within nine months of the date of the request for arbitration. Alternatively, interconnection agreements could contain a self-executing provision for renegotiation or arbitration of rates within the nine-month timeframe preceding the expiration date of the current agreement.

³³ 47 U.S.C. § 252(b)(4).

D. Review of Confiscatory Rates

ACS urges the Commission to clarify the procedures for seeking review of rates that may be confiscatory so that ILECs can obtain effective relief from confiscatory rates. Currently, there is no timely or effective forum to review UNE rates that have a confiscatory effect. In the TELRIC NPRM, the Commission cites to its purported offer to ILECs “to seek relief from the TELRIC pricing rules if they could demonstrate the rules had been *applied* to produce confiscatory rates.”³⁴ In the *Local Competition First Report and Order*, the Commission indicated that “[i]ncumbent LECs may seek relief from the Commission’s pricing methodology if they provide specific information to show that the pricing methodology, as applied to them, will result in confiscatory rates” and promised to revisit the issue of confiscatory pricing.³⁵ Subsequently, the Supreme Court held that claims that the TELRIC methodology effects a taking without just compensation in violation of the Fifth Amendment are not ripe.³⁶ The Court refused to find the TELRIC methodology *per se* confiscatory, but noted that individual rates could have a confiscatory effect.³⁷

When ACS presented the Commission with evidence of confiscatory rates in Fairbanks, the Commission refused to conduct the review.³⁸ Despite ACS’s *prima facie* case showing that the RCA failed to follow the FCC’s TELRIC methodology, and that the rates in Fairbanks were confiscatory, the Commission declined to exercise jurisdiction, advising ACS to

³⁴ TELRIC NPRM at ¶ 40 (emphasis added).

³⁵ *Local Competition First Report and Order* at ¶ 739.

³⁶ *Verizon Communications, Inc. v. FCC*, 533 U.S. 467 at 524 (2002).

³⁷ *See id.* at 524-25.

³⁸ *See ACS of Anchorage, Inc. and ACS of Fairbanks, Inc., Emergency Petition for Declaratory Ruling and Other Relief Pursuant to Sections 201(b) and 252(e)(5) of the Communications Act*, WC Docket No. 02-201 at 43-47 (filed Jul. 24, 2002) (“ACS UNE Petition”).

seek review of the rates in federal district court pursuant to Section 252(e) of the Act. The Commission's order denying ACS's UNE petition indicated that the Commission would consider "a challenge to *TELRIC* . . . but any challenger needs to . . . show with 'specific information' that a confiscatory rate *is bound to result*."³⁹ However, the Supreme Court has determined that until rates are set by the states, determinations on confiscation are not ripe. Thus, under current case law, there is no effective opportunity for bringing a takings claim to the Commission. In the *TELRIC* NPRM, the Commission offers to review claims by ILECs that *TELRIC* rates set by the state have a confiscatory effect. ACS heartily supports the idea of independent reviews of state ratemaking by the FCC where there is evidence that rates are so low as to be confiscatory. As the expert agency charged with establishing the rate-setting framework, the Commission has both the expertise and the duty to ensure its UNE rules do not produce a confiscatory result. And for reasons stated by ACS in its petition, the Commission may preempt state rulings where such actions are inconsistent with the Act.⁴⁰

In ACS's experience, federal court review has proven wholly ineffective in providing relief from confiscatory rates. ACS petitioned the U.S. District Court of Alaska to review the confiscatory nature of the unreasonably low UNE rates in Fairbanks and Juneau pursuant to Section 252(e) of the Act.⁴¹ During this proceeding, the RCA attempted to avoid judicial review, claiming sovereign immunity under the Eleventh Amendment of the U.S.

³⁹ *ACS of Anchorage, Inc. and ACS of Fairbanks, Inc., Emergency Petition for Declaratory Ruling and Other Relief Pursuant to Sections 201(b) and 252(e)(5) of the Communications Act*, Memorandum Opinion and Order, 17 FCC Rcd 21114 at ¶ 12 n. 55 (2002), citing *Local Competition First Report and Order* at ¶ 739 (emphasis added).

⁴⁰ ACS UNE Petition at 42-43.

⁴¹ *ACS of Fairbanks, Inc. v. GCI Communications Corp.*, A00-288 CIV, Amended Complaint for Declaratory Judgment, Preliminary Injunction, and Permanent Injunction (filed by ACS Mar. 13, 2001); ACS of Fairbanks, GCI Communications Corp., Plaintiff's Motion to Enjoin Implementation of Interconnection Agreements, A00-288 CIV (JKS) (Mar. 13, 2001).

Constitution.⁴² When the district court dismissed the sovereign immunity defense, the RCA appealed that decision to the Ninth Circuit Court of Appeals.⁴³ Although the Ninth Circuit ultimately ruled that ACS could proceed with the suit, after litigating the matter for over two years, the case was recently dismissed as moot because new UNE rates are currently being arbitrated due to the expiration the current interconnection agreement in October 2003.⁴⁴

As this case illustrates, there has been no way to get an effective ruling on confiscatory rates, either in the courts or at the FCC. Today, ACS finds itself in arbitration to determine new UNE rates, while the RCA has no more guidance than it did previously on how to apply TELRIC in a manner that is not confiscatory. The Commission's expertise on UNE rates and the TELRIC methodology makes it the most logical forum for reviewing takings challenges. The only possible relief from confiscatory rates is for the Commission directly and explicitly to establish a process for reviewing claims of confiscation.

⁴² See *ACS of Fairbanks, Inc. v. GCI Communication Corp.*, A00-288 CIV , RCA Notice of Appeal to the United States Court of Appeals for the Ninth Circuit (filed Mar. 22, 2001) (USCA 01-35344).

⁴³ *ACS of Fairbanks, Inc. v. GCI Communication Corp.*, Order, A00-288 CIV (Mar. 20, 2001).

⁴⁴ *ACS of Fairbanks, Inc., et al. v. GCI Communication Corp.*, Dismissal from Parties Stipulation, A00-288-CIV (HRH) (D. Alaska Oct. 15, 2003).

IV. UNIVERSAL SERVICE ISSUES – TELRIC NPRM § IV.A.3

A. Use of USF Inputs Has Had Detrimental Effects On ACS's Markets

ACS agrees with the Commission's suggestion in the TELRIC NPRM that use of the Synthesis Model default inputs, developed for universal service fund ("USF") purposes, should not apply in establishing forward-looking UNE rates.⁴⁵ The Commission has repeatedly advised against using nationwide cost inputs to develop UNE prices.⁴⁶ Nonetheless, the RCA has established UNE rates in Fairbanks and Juneau on this basis. Basing rates in these markets on costs that are entirely unrelated to the actual costs of entering these markets has skewed the market entry determinations of CLECs, resulting in an artificially high level of competition. For example, GCI has garnered over 21 percent of the local exchange market in Fairbanks since 2001, and 19 percent of the local exchange market in Juneau since 2002.⁴⁷ As described above, these below-cost UNE rates have rendered ACS unable to recover its costs or to invest in the network.

Therefore, in this proceeding the Commission should clarify that UNE rates generated using cost inputs having no relation to actual costs in a specific market are inadequate

⁴⁵ See TELRIC NPRM at ¶ 47.

⁴⁶ See, e.g., *id*; *Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration*, CC Docket No. 00-218, Memorandum Opinion and Order, DA 03-2738 at ¶ 51 (rel. Aug. 29, 2003); *Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps*, CC Docket No. 96-262, Order, FCC 02-161, ¶ 36 (rel. Jun. 5, 2002); *Federal-State Joint Board on Universal Service; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket 96-45, Tenth Report and Order, 14 FCC Rcd 20156, ¶ 32 (1999) ("Inputs Order"); *Federal-State Joint Board on Universal Service; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket 96-45, Fifth Report and Order, 13 FCC Rcd 21323 at ¶ 12 (1998) ("Platform Order"); see also, 47 C.F.R. § 51.505(e)(2).

⁴⁷ Comments of General Communication, Inc., *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 at 7 (filed May 5, 2003). ACS believes that GCI's market share in Fairbanks has grown close to about 24% and in Juneau to about 21% since GCI filed those comments.

to achieve the goals of TELRIC-based rates. As part of this mandate, the Commission should explicitly reject UNE rates based on nationally-averaged, non-rural default cost inputs developed for USF purposes. Moreover, even if nationally-averaged default cost inputs were an appropriate basis for rates, the current default inputs that the Commission developed in 1999 are stale and outdated.

B. Impact of UNE Rates and USF Support

The Commission also requests comment on the relationship between the UNE pricing rules and the universal service rules.⁴⁸ Currently, CLECs are entitled to USF support that is based on the ILECs' costs. ACS has requested, in a separate docket, that the Commission base USF support to competitive eligible telecommunications carriers ("CETCs") on their own costs.⁴⁹ However, the Commission should, in this proceeding, consider the impact of improper UNE rates combined with the USF support being paid to UNE-based CLECs. There is an inherent mismatch in the TELRIC rules and the USF support rules because CETCs receive high-cost loop support based on the ILEC's embedded costs, and UNE-based CETCs' costs are based on hypothetical forward-looking costs. Although forward-looking costs for any particular ILEC may be higher or lower than embedded costs, UNE prices that have no basis in the ILEC's actual costs in the market will magnify the disparity between cost-based USF support and forward-looking UNE rates. In ACS's markets, UNE prices that are well below actual costs, based on a hypothetical carrier standard, have created an opportunity for GCI to obtain high-cost loop support that well exceeds GCI's loop costs. Such support, by definition, is not used for the

⁴⁸ TELRIC NPRM at ¶ 48.

⁴⁹ See Comments of ACS of Fairbanks, Inc. *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 (filed May 5, 2003); see also, *ACS of Anchorage, Inc. and ACS of Fairbanks, Inc., Emergency Petition for Declaratory Ruling and Other Relief Pursuant to Sections 201(b) and 252(e)(5) of the Communications Act*, WC Docket No. 02-201 (filed Jul. 24, 2002).

purposes intended and instead provides GCI with an additional windfall gain on top of the already advantageous pricing the CLECs gets under today's UNE rates.

V. NETWORK ASSUMPTIONS SHOULD RELATE TO THE CARRIER WHOSE UNES ARE BEING PRICED AND THE MARKET – TELRIC NPRM §IV.B

A. General Theory – TELRIC NPRM § IV.B.1

1. Forward-Looking Costs Should Be Based On A Hypothetical Network, Not A Hypothetical Carrier

In the TELRIC NPRM, the Commission suggests that forward-looking costs could be more closely tied to the actual costs of the ILEC in question.⁵⁰ ACS agrees, and urges the Commission to clarify that TELRIC is designed to predict the cost of a hypothetical *network*, and not a hypothetical *carrier*. The hypothetical network rule applies to the design of the network, not the cost to the particular ILEC of constructing the hypothetical network. Thus, the Commission should direct the states to take into account actual characteristics and circumstances of the ILEC for whom UNE rates are being determined.

The Commission and the Supreme Court have already supported a TELRIC methodology that accounts for inefficiencies. In *Verizon v. FCC*, the Court found that TELRIC does not require an assumption of a perfectly competitive or perfectly efficient market.⁵¹ The Commission should provide states with guidance to ensure that cost inputs are grounded in reality. The Commission has indicated on several occasions that the costs measured by TELRIC should be those of the incumbent itself, and should be the costs the ILEC actually expects to incur.⁵² Further, even the rates generated with realistic forward-looking cost inputs should not be

⁵⁰ TELRIC NPRM at ¶¶ 4, 52.

⁵¹ *Verizon Communications, Inc. v. FCC*, 535 U.S. 467 at 504 (2002).

⁵² *Local Competition First Report and Order* at ¶ 685; Reply Brief for Petitioners United States and the Federal Communications Commission at 6, *Verizon Communications, Inc. v. FCC*, 535 U.S. 467 (2002) (Nos. 00-511, 00-555, 00-587, 00-590, 00-602); *Verizon Virginia Arbitration Order* at ¶¶ 30, 34.

applied without considering whether those rates are reasonable for the market.⁵³ These principles suggest some obvious “don’ts” for the development of UNE rates:

- Don’t assume a model or hypothetical carrier;
- Don’t assume the most efficient carrier imaginable; and
- Don’t assume a carrier in a different geographic location, or with different scale and scope economies.

The approach that ACS proposes is consistent with the Commission’s current TELRIC framework. Currently, the TELRIC rules do not forbid states from looking at the real-world attributes of a network providing local services in particular markets.⁵⁴ As ACS discusses below, such factors as labor prices, materials prices (including volume discounts for which the ILEC actually qualifies), local laws governing where facilities may be placed, local construction time tables (especially important in Alaska), loop lengths, switch locations, strength of competitors, and other real-world factors can and should be considered in developing TELRIC prices for UNEs. Although forward-looking costs that are based on actual costs in the market are still predictive, the predictions are more likely to correspond to the costs that a facilities-based carrier in the market will in fact incur.⁵⁵ Only then will UNE rates send economically rational signals for market entry and facilities investment.

⁵³ Prefiled Reply Testimony of Howard A. Shelanski on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-95-89 at 18-19 (filed Oct. 13, 2003) (“Shelanski Prefiled Reply Testimony”).

⁵⁴ Shelanski Prefiled Reply Testimony at 2.

⁵⁵ Prefiled Direct Testimony of Howard A. Shelanski on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-95-89 at 7 (filed Aug. 29, 2003) (“Shelanski Prefiled Direct Testimony”).

2. TELRIC Pricing Should Reflect Attributes of the ILEC And The Market In Which It Serves

In order to promote the goals of TELRIC pricing, the hypothetical network should be modeled on characteristics of the particular ILEC and the market in which it operates. Because states are not currently required to consider the actual locations of facilities and the environment in which the network is actually located, UNE rates have not reflected the forward-looking costs that a facilities-based provider would realistically incur. ACS agrees with the Commission's tentative conclusion that the TELRIC rules should take into account "real-world attributes of the routing and topography of an incumbent's network."⁵⁶ Real-world considerations of the ILEC and its network are consistent with the mandate in the current rules to take into account the existing locations of the ILEC's wire centers.⁵⁷

Physical attributes of the geographic area in which the ILEC's markets are located and other local factors are one set of relevant considerations to TELRIC pricing. States should take into account the routing and topography of the ILEC's network. For example, due to the harsh terrain and short construction season, construction costs are significantly higher in Alaska than in the lower 48 states.⁵⁸ Further, local ordinances in Anchorage require the burying of all cable.⁵⁹ TELRIC prices that are based on the particular ILEC also should consider other local

⁵⁶ TELRIC NPRM at ¶ 52.

⁵⁷ 47 C.F.R. § 51.505(b)(1); *Local Competition First Report and Order* at ¶ 685; *see also*, TELRIC NPRM at ¶ 49

⁵⁸ Prefiled Reply Testimony of William J. Wilks on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89 at 8-9 (filed Oct. 13, 2003) ("Wilks Prefiled Reply Testimony").

⁵⁹ Prefiled Direct Testimony of Steven D. Cinelli on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89 at 12 (filed Aug. 29, 2003) ("Cinelli Prefiled Direct Testimony").

factors that affect forward-looking costs, such as actual labor rates and materials costs (including reasonable assumptions regarding the amounts of labor and materials necessary to build the network),⁶⁰ codes and standards for construction, and the physical configuration of the ILEC's existing network. The UNE rates in Fairbanks and Juneau, described above, are artificially low in part because labor costs are significantly higher in Alaska than the national average.⁶¹

TELRIC rates that reflect attributes of the local market conditions should also take into account the actual costs of complying with the codes and standards applicable to the ILEC, including OSHA and other federal laws. For example, federal laws requiring ACS to use union contractors and laws in Anchorage requiring facilities to be placed under ground drive up labor and construction costs.⁶² Presumably, other facilities-based carriers would face the same OSHA and underground facilities requirements and the corresponding costs. Therefore, UNE rates must reflect these costs in order to signal efficient entry to competitors. If a competitor has more efficient costs than the ILEC, such as lower non-union labor rates, then the competitor has the opportunity to construct its own facilities at a lower cost and can compete on that basis. Instead of artificially lowering the ILEC's cost for purposes of developing UNE rates, efficiencies of the competitors should benefit customers through more efficient networks. Competitors will not be encouraged to demonstrate their efficiency if they can purchase UNEs that are already priced as if the competitors had efficient facilities.

⁶⁰ For instance, the amount of labor required to build network facilities in Alaska will be higher than the U.S. average because the harsh climate in Alaska necessitates longer work schedules.

⁶¹ Wilks Prefiled Reply Testimony at 8-9.

⁶² See, e.g., Cinelli Prefiled Direct Testimony at 11-12; Prefiled Reply Testimony of Steven D. Cinelli on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89 at 9-10 (filed Oct. 13, 2003) ("Cinelli Prefiled Reply Testimony").

Because the cost inputs that were used to generate the UNE rates in ACS's service areas did not reflect higher costs specific to Alaskan markets, the below-cost UNE rates distorted competitors' decisions to enter these market. The UNE rates must also allow ACS to recover these costs in order to effectively achieve the goals of TELRIC pricing. Further, any assumptions regarding investment in technology should be efficient and economically rational. The Commission should require that network assumptions be subject to the types of service quality requirements and standards to which the ILEC is subject under applicable law and market standards.

The Commission should also direct state commissions to account for actual cost characteristics of the ILEC in developing a hypothetical network model, particularly with respect to non-BOC ILECs. Specifically, the Commission should make clear that cost inputs that are based on the costs of the RBOCs are inappropriate for non-BOC ILECs. Although the Commission has repeatedly advised that the Synthesis Model and default inputs established for non-rural carriers should not be used to develop UNE prices, the RCA has set rates in rural Fairbanks and Juneau based on these cost inputs. In addition to the failure to reflect costs in the specific market, such an approach also disregards the difference in bargaining power and other regulatory considerations. ACS is significantly smaller in all respects than the BOCs and thus, does not have the bargaining power and cannot achieve the same economies of scale and scope as the BOCs. ACS's smaller size impacts the cost assumptions for construction of plant and operation of the network and the business.⁶³

⁶³ Additionally, BOCs and other ILECs face different regulatory concerns. When comparing UNE rates of each, the BOCs' UNE rates are often lower than TELRIC-based rates due to Section 271 negotiations and merger conditions. See Prefiled Reply Testimony of David C. Blessing on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications*

States can ensure that forward-looking costs are based on the actual costs in the market by starting with the costs to the ILEC of building facilities today, and adjusting for reasonably foreseeable forward-looking changes.⁶⁴ Based on historical trends or known factors about certain market characteristics, states can determine whether specific costs are likely to trend upward or downward in the future. Although the resulting decisions and rates will still be predictive, they will at least be based on real costs.⁶⁵ By contrast, the rates generated under the current rules are not tied to any realistic range. Disparities between predictions of forward-looking costs and actual costs could be magnified when they are plugged into a cost model and incorporated into UNE rates.

In the Anchorage proceeding, GCI has indicated that it agrees with ACS on certain real-world assumptions about cost; however, GCI continues to propose cost inputs that are not based on any costs that are reasonable for the Anchorage market. For example, although GCI's expert agreed with ACS that, based on historical trends, the costs of copper loops and other outside plant equipment are increasing,⁶⁶ GCI's cost input proposals do not reflect this. The lack of guidance on cost inputs has produced proposed UNE loop rates that range from \$7 to \$25, both of which have been argued to be consistent with the TELRIC methodology.

for the Purpose of Instituting Local Exchange Competition, U-96-89 at 17 (filed Oct. 13, 2003) ("Blessing Prefiled Reply Testimony").

⁶⁴ See TELRIC NPRM at ¶ 60.

⁶⁵ Shelanski Prefiled Direct Testimony at 7.

⁶⁶ Testimony of Michael J. Majoros on Behalf of General Communication Inc., Before the Regulatory Commission of Alaska, *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-95-89, Public Hearing, Volume XII at 1394 (Nov. 10, 2003) ("Majoros Testimony").

3. The Hypothetical Network Must Reflect A Mix Of Old And New Technology

An assumption that the entire network will be replaced instantaneously is unrealistic, and thus, generates TELRIC prices that do not reflect the actions of an efficient ILEC.⁶⁷ ACS supports the Commission's recommendation that the hypothetical network reflect a mix of old and new technologies at any given time. In the *Verizon Virginia Arbitration Order*, the Commission also rejected a full replacement model by adopting Verizon's proposed cost study for switching and transport.⁶⁸ Verizon's cost study used as a starting point its existing network configuration and adjusted technology assumptions for this network to represent the mix of technologies that Verizon deploys today and applied forward-looking adjustments to its existing network based on current engineering and deployment guidelines.⁶⁹

In competitive markets, firms do not instantaneously replace all of their facilities upon the introduction of new technologies.⁷⁰ It would be inefficient for a carrier to rebuild its entire network using the newest technology as of a particular date. In reality, an efficient carrier would replace the network incrementally, making use of existing facilities that retain economic value even after the new technology becomes available. Therefore, a full replacement assumption is wholly inconsistent with the realities of an efficient carrier.⁷¹ Additionally, an instantaneous replacement model is not necessarily cost-minimizing over time because such a

⁶⁷ Shelanski Prefiled Reply Testimony at 6.

⁶⁸ *Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration*, CC Docket No. 00-218, Memorandum Opinion and Order, DA 03-2738 at ¶¶ 32, 55-56 (rel. Aug. 29, 2003) ("*Verizon Virginia Arbitration Order*").

⁶⁹ *Id.* at ¶ 42.

⁷⁰ TELRIC NPRM at ¶ 50.

⁷¹ Shelanski Prefiled Reply Testimony at 12.

model is likely to entail very high capital and depreciation costs.⁷² A true long-run cost model reflects the incremental replacement of technology.

Further, in order to preserve the goals of TELRIC pricing, CLECs should not immediately receive the full cost benefit of a newer and cheaper technology without having to risk any investment in capital. Although old technologies may become less valuable as new technologies become available, competitors will not be encouraged to invest in their own facilities, even incrementally, as long as they can lease UNEs at a cost that assumes an entire network of cheaper technology.

4. Decisions Made By CLECs in the Market

In the TELRIC NPRM, the Commission asks whether network assumptions should reflect evidence of the network decisions made by CLECs in the market.⁷³ ACS believes that some types of evidence of CLEC behavior may be relevant to UNE pricing. States should consider the costs incurred by CLECs in deploying network facilities, for example, as a relevant point of comparison for certain forward-looking costs. Where CLECs have constructed their own facilities or have comparable assets as the ILEC, the CLECs' costs can serve as a benchmark for reasonableness of the cost inputs being used.

In Anchorage, GCI is a formidable competitor that has captured almost half of the local exchange market. As the incumbent cable operator, GCI has the ability to exercise market power and enjoy economies of scale and scope. Competition from GCI has indeed forced ACS to act efficiently. GCI has built its own facilities in subdivisions in Anchorage. GCI's recent experience in constructing their own facilities in two subdivisions in Anchorage is exactly the

⁷² *Id.* at 13, 15.

⁷³ TELRIC NPRM at ¶ 56.

type of real-world verification that TELRIC models generally lack.⁷⁴ Because the construction costs on these projects were comparable to ACS's construction costs, ACS proposed costs that were based on these actual costs.⁷⁵ However, the current TELRIC rules, which do not place any limits or boundaries on costs, has allowed GCI to propose forward-looking construction costs that are unrealistically low for the Anchorage market. GCI consistently proposes cost inputs that are significantly lower than both ACS's and GCI's costs.⁷⁶ In some cases, the costs that GCI proposed were almost a third of the cost in GCI's actual experience.⁷⁷ UNE rates based on cost inputs that cannot possibly be achieved in the market will not promote efficient competition and improvement in network facilities. Thus, if neither the ILEC nor the CLEC can achieve the hypothetical costs in the model, states should be required to provide a compelling justification for the lower cost inputs.

Additionally, the Commission should direct states to consider decisions by a CLEC to transfer their customers to their own facilities. TELRIC rates are designed to allow the ILEC to recover certain costs over time; however, this assumes that the CLEC will never leave the ILEC's facilities. Such an assumption is contrary to the goals of facilities-based investment that are built into the TELRIC rules. Evidence that a CLEC will deploy its own facilities should

⁷⁴ Blessing Prefiled Reply Testimony at 5.

⁷⁵ The validity of the comparison is further strengthened by the fact that ACS and GCI use the same contractors to provision loop plant and each has similar buying power from equipment vendors. *See* Blessing Prefiled Reply Testimony at 5.

⁷⁶ Cinelli Prefiled Reply Testimony at 20.

⁷⁷ GCI's actual investment per loop for the Dallas and Aurora subdivisions of Anchorage were \$2,228 and \$1,284, respectively. *See* Wilks Prefiled Reply Testimony at 8. By contrast, GCI's proposed models produce an investment per loop from \$385 to \$552. *See* Prefiled Opposition Testimony of William J. Wilks on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89 at 4 (filed Sept. 29, 2003).

signal to states that UNE rates should be adjusted to reflect shorter asset lives, shorter recovery periods for non-recurring charges, and higher costs of capital to account for the increase in future competitive risks.

The competitive risk of stranded facilities looms in the near future for ACS of Anchorage, Inc. GCI has announced its plans to commercially deploy cable telephony to provide local exchange service in Alaska, where GCI's cable television facilities pass over 95% of households.⁷⁸ GCI already has conducted trials of its telephony service, and projected that it would be able to commercially provide service over its own cable facilities in Anchorage beginning in 2004.⁷⁹ Therefore, the costs of any facilities that ACS has constructed to make available access to UNEs will be unrecoverable unless forward-looking UNE prices account for GCI's future plans. In order to encourage ILECs to continue to invest in their facilities, and to motivate CLECs to move towards their own facilities, the Commission should direct states to consider CLECs' network deployment plans in setting rates.

B. Definition of Efficiency

Another flaw in the current UNE rules is the utterly open-ended use of the "efficient" network architecture standard. The Commission has used the terms "efficient" and "efficiency" with little guidance for states trying to determine when that standard has been achieved. States are reluctant to use historic costs as a starting point for UNE prices because they fear that ILECs may not have had incentives to be as efficient as possible in incurring those costs. But they have no basis on which to determine what efficiently-incurred costs might be.

⁷⁸ Prefiled Testimony of Dana L. Tindall, Senior Vice President, General Communication Inc., Before the United States Senate Committee on Commerce, Science and Transportation, Communications Subcommittee, *Hearing on the Current Status and Future of the Universal Service Fund*, at 3 (filed April 2, 2003).

⁷⁹ *Id.* at 5-6.

The Commission should adopt a standard of efficiency so that UNE prices send the correct economic signals regarding investment and achieve the necessary level of cost recovery.⁸⁰ ACS proposes that the actual costs incurred by an ILEC should be presumed to be efficient after the ILEC has been effectively competing for a period of three years. After such three year period, it can be presumed that market forces will have caused the ILEC's operations to become efficient, and the ILEC's UNE prices can be based on then-current costs.

At a minimum, the Commission should warn states that they cannot simply cut costs and arbitrarily invent cost reductions based on misguided notions of efficiency. UNE rates based on cost structures that are not achievable in the market will result in inefficient entry. For example, in the Anchorage rate proceeding, ACS has proposed a cost input for corporate operations expense of approximately \$8.00. On the other hand, GCI has proposed a cost of \$0.66.⁸¹ The wide disparity in the proposals is attributable to different assumptions regarding efficiency: GCI's proposal assumes an unrealistic level of efficiency that cannot be achieved, while ACS's proposal reflects actual costs of its operations. Therefore, the Commission should mandate that, to the extent there is any question that a network architecture is efficient, states cannot depart from the actual cost evidence.

In a competitive environment, the ILEC is forced to be efficient in order to compete with the CLECs in the market. If the ILEC operates inefficiently, the CLEC will leave the ILEC stranded by deploying its own facilities. Thus, market forces will motivate the ILEC to maintain efficient practices in order to keep CLECs from leaving the network. ACS urges the

⁸⁰ See TELRIC NPRM at ¶ 57.

⁸¹ Prefiled Opposition Testimony of David C. Blessing on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89 at 18-19 (filed Sept. 29, 2003).

Commission to consider the situation in ACS's markets when adopting a standard for efficiency. Once an ILEC faces competition, as ACS does, there is a sound basis for presuming that it incurs costs efficiently. In this circumstance, prices for UNEs should not be based on cost models that generate lower prices.⁸²

C. TELRIC Based Rates May Be Higher Or Lower Than Rates Based On Embedded Cost

In the TELRIC NPRM, the Commission implies that higher UNE rates will necessarily result from using more realistic network assumptions.⁸³ ACS disagrees with the presumption that TELRIC-based prices will always be lower than embedded cost-based pricing. If TELRIC is properly applied in a manner that promotes investment in facilities, the forward-looking cost inputs could be higher or lower than embedded cost.

As discussed above, when developing forward-looking rates, state commissions should start with actual costs in the market (either the ILEC's or the CLEC's current costs) and adjust these upward or downward depending on characteristics of the relevant market.⁸⁴ It is true that some forward-looking costs will be higher if such costs are assumed to trend upward. For instance, labor costs have historically trended upward.⁸⁵ In addition, copper prices (as well as prices of other cable and wire materials) have trended upward.⁸⁶ In Anchorage, new ordinances requiring that all cable be buried will cause the cost of deploying new lines to increase dramatically because approximately 75 percent of network costs relate to construction, which is

⁸² Shelanski Prefiled Reply Testimony at 8-9.

⁸³ TELRIC NPRM at ¶ 59.

⁸⁴ Wilks Prefiled Reply Testimony at 5.

⁸⁵ See Wilks Prefiled Reply Testimony at 9.

⁸⁶ Both parties' testimony in the Anchorage arbitration supported the notion that these costs have been rising. See Wilks Prefiled Reply Testimony at 9; Majoros Testimony at 1394.

largely dependent on labor rates.⁸⁷ Therefore, realistic forward-looking rates based upon any of these costs should be higher in the future. Additionally, there are no economies of scale in labor; therefore, cost inputs that depend on labor should not decrease as the volume increases.⁸⁸

On the other hand, certain costs will trend downward. Switching costs have decreased over time due to the advancement from mechanical to digital switch technology. By factoring in each of these trends, forward-looking costs will be higher or lower than actual current costs in the market, depending on specific attributes of costs in the relevant market and depending on the extent to which the regulator has already considered historical trends and characteristics of the particular market. Forward-looking cost-based rates therefore may be lower or higher than rates based on historic costs for different UNEs.

D. Minimization of Discovery and Production Burdens

ACS supports the Commission's proposed goal of minimizing discovery and production burdens.⁸⁹ The Commission should direct states to place reasonable limitations of time and scope of discovery requests in pricing proceedings. It is reasonable for state commissions to impose limits on discovery that are similar to those imposed by courts. On numerous occasions, GCI served burdensome information and data requests on ACS, with which ACS has complied. On the other hand, when ACS has requested information from GCI, GCI has refused to provide the information. Reciprocal limits on discovery would allow state commissions and the arbitrating parties to obtain meaningful information without an open-ended discovery period.

⁸⁷ Cinelli Prefiled Direct Testimony at 12; Cinelli Prefiled Reply Testimony at 20.

⁸⁸ Wilks Prefiled Reply Testimony at 9.

⁸⁹ See TELRIC NPRM at ¶ 61.

Further, if the Commission adopts guidelines that relate the costs of an efficient carrier to costs incurred by other carriers in the market, all parties should have access to such cost information. A competitive carrier, such as GCI, that is close to deploying its own facilities or, in some cases, already has its own facilities, should know the efficient level of costs in the market. Presumably, these carriers have researched the costs on which they have based their market entry decisions. Therefore, if efficient cost levels are in part based on the costs of the CLECs in the market, the CLECs should be required to provide evidence of their own costs in the UNE rate proceeding.

Finally, ACS asks that the Commission provide guidelines for best evidence in state UNE rate proceedings. By providing a hierarchy of reliable evidence, state commissions can determine forward-looking costs with greater accuracy. The Commission should clarify that state commissions, in evaluating evidence, should place the greatest weight on documented evidence of the ILEC's current costs, adjusted for inflation and efficiency. State commissions could also rely on costs of other carriers in the market in question that are comparable to the ILEC's costs; these would not have as much relevance as the ILEC's actual costs, but would could be a useful reference point. Even less reliable, states could consider evidence of the average costs of other carriers, although states should not use such evidence unless other more relevant evidence is unavailable. The Commission should caution states to give little weight to opinion testimony unless such testimony is accompanied by documented evidence.

VI. SPECIFIC PRICING INPUTS – TELRIC NPRM § IV.B.2

Any rules that the Commission adopts to ground TELRIC in real costs should include specific guidance with respect to the different UNE cost inputs. These inputs, while assuming a hypothetically efficient network, must reflect the attributes of and costs facing facilities-based carriers in the market. As discussed above, only when state commissions use a realistic measure of forward-looking costs will TELRIC-based UNE rates promote efficient entry of competition and investment in network facilities.

A. Network Routing and Construction – TELRIC NPRM § IV.B.2.a

ACS supports the proposal to adopt routing and construction cost assumptions that are more closely tied to an ILEC's existing network. Forward-looking cost inputs should be tied to actual network costs in several respects. First, the Commission should clarify that prices be determined based not only on the actual location of the wire centers, but also on the actual location and conditions of the network routes. The major component of the construction cost input is labor costs.⁹⁰ State commissions should be directed to focus its efforts on developing an accurate forward-looking cost for trenching along the current right-of-way routes as they currently exist. Second, TELRIC pricing should take into consideration increased trenching costs due to compliance with federal, state and local regulations applicable to network construction. For example, ACS must bear higher costs of complying with union labor requirements, OSHA regulations for trenches, and local ordinances in Anchorage that require all

⁹⁰ Prefiled Reply Testimony of Steven D. Cinelli on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89 at 20-21 (filed Oct. 13, 2003) ("Cinelli Prefiled Reply Testimony").

lines to be placed under ground.⁹¹ Presumably, a new facilities-based entrant would be subject to the same types of costs. Therefore, these costs are crucial to the CLECs' market entry decisions, and should be reflected in TELRIC prices.

⁹¹ Prefiled Direct Testimony of Steven D. Cinelli on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89 at 11-12 (filed Aug. 29, 2003) ("Cinelli Prefiled Direct Testimony"); Cinelli Prefiled Reply Testimony at 9-10.

B. Structure Sharing – TELRIC NPRM § IV.B.2.c

In the TELRIC NPRM, the Commission states that the TELRIC model assumes that the greater the level of structure sharing, the lower the cost of providing the element that should be presumed to the ILEC.⁹² ACS disputes the basis of this assumption. While it is true that structure sharing would reduce the cost with respect to a carrier that actually shares the conduit or other structures with other carriers or utilities, a new carrier entering the market today may not be able to share these supporting structures. Depending on when the carrier enters the market, the conduit may be full or construction of the trench may already be completed. Thus, a reduction in the UNE price based on assumptions of structure sharing may distort entry decisions and encourage uneconomic entry.

⁹² TELRIC NPRM at ¶ 71.

C. Fill Factors – TELRIC NPRM § IV.B.2.d

The fill factor input, which accounts for the percentage of the excess capacity built into the network for future growth, should reflect local conditions and the level of competition in the market, but should fall into a range based on national levels. Unlike other cost factors, the fill factor should be somewhat consistent on a national level because the amount of spare capacity in every market depends on considerations of public safety, health and welfare, in addition to local market conditions. Unless there is evidence that indicates otherwise, TELRIC rules should direct states to use a fill factor that is consistent with industry custom for constructing new networks.

However, in addition to fill factors, the Commission should require that UNE rates reflect a demand factor in markets where the level of total customer demand is relatively stable and where facilities-based competition exists or is likely to emerge. When competitors move customers onto its own facilities and off of the ILEC's network, the network costs of the ILEC do not decrease materially. ILECs are charged with carrier-of-last-resort ("COLR") responsibilities and, as such, are required to provide ubiquitous service and to extend lines to all customers. As the COLR, ACS must build a network capable of serving all customers in the market. Thus, when GCI moves its customers to its cable telephony platform, as promised, ACS will be unable to shrink its capacity or decrease its lines in certain areas because, in order to serve all customers requesting service, there is no way to determine ahead of time where customers will be located.

GCI has argued that the fill factor for developing rates in Anchorage should be higher because facilities-based investment in the market should decrease the ILEC's need for spare capacity. However, fill factors do not adequately account for fluctuations in network

demand relating to facilities-based competition. Once GCI leaves ACS's facilities stranded, the level of spare capacity on ACS's network will be higher. The cost of this spare capacity cannot be recovered by the ILEC in a market where customer demand is not likely to approach the level of capacity on both the ILEC and CLEC networks. Therefore, a demand adjustment should be reflected in UNE rates in markets where there is an expectation of facilities-based competition.

D. Switch Discounts – TELRIC NPRM § IV.B.2.e

In order to reflect realistic costs, the assumption for switch discounts should be closely based on the ILEC's actual discounts in contracts with switching equipment vendors. It is unrealistic to assume, as GCI has proposed in rate proceedings, that ACS's forward-looking switch discount be consistent with the levels achieved by the BOCs. Moreover, the switch discount should not be determined based on an assumption that the ILEC will simultaneously replace all of its existing switches. As discussed above, the Commission has rejected a full replacement model for the hypothetical network; the assumptions used to determine switch discounts should be consistent with other network assumptions.

VII. OTHER INPUT ASSUMPTIONS SHOULD RELATE TO COMPETITIVE REALITY IN THE MARKET

A. Cost of Capital – TELRIC NPRM § IV.C.

In the *Triennial Review Order*, the Commission clarified that a TELRIC-based cost of capital should reflect the risks of a competitive market.⁹³ Even if the Commission adopts TELRIC guidelines that provide for the use of more realistic network assumptions, the cost of capital assumption should still reflect competitive risks.⁹⁴ In a competitive market, ILECs face the risk of losing customers to other facilities-based carriers. This risk will exist as long as UNE rates properly encourage CLECs to enter the market and to move towards their own facilities. Therefore, higher investment returns will still be required in a competitive environment before investors will risk capital investment in loops.⁹⁵

The Commission should establish a graduated floor for a carrier's forward-looking cost of capital, starting at the 11.25% rate of return that is currently authorized at the federal level and expected by lenders and investors, and increased based on the level of competition in the market. For instance, in a market with facilities-based competition, the increased risk to the ILEC should warrant a cost of capital floor that is closer to 15%. Establishing a reasonable minimum cost of capital will ensure that the assumed forward-looking rate is sufficient to account for fluctuations in demand resulting from meaningful facilities-based competition.

⁹³ *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, FCC 03-36 at ¶¶ 680-84 (rel. Aug. 21, 2003) ("*Triennial Review Order*").

⁹⁴ See TELRIC NPRM at ¶ 84.

⁹⁵ Prefiled Direct Testimony of Thomas R. Meade on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89 at 9, 11 (filed Aug. 29, 2003) ("Meade Prefiled Direct Testimony").

In the *Triennial Review Order*, the Commission cited Verizon and SBC's request that the 11.25% level be a reasonable starting point for determining the forward-looking cost of capital.⁹⁶ This approach is consistent with the Commission's *Verizon Virginia Arbitration Order*; the Commission determined that Verizon Virginia's weighted average cost of capital was higher than the currently authorized rate of return.⁹⁷ Because the 11.25% level was set based on market conditions existing in 1996, a forward-looking adjustment will always be higher when assuming a future market that will be more competitive due to the emergence of facilities-based competition and in which the ILEC is no longer the dominant local telephone company.⁹⁸ In order to ensure that competitive risk in the market is properly accounted for, the floor for cost of capital should be higher than 11.25%.

⁹⁶ *Triennial Review Order* at ¶ 678.

⁹⁷ *Verizon Virginia Arbitration Order* at ¶ 104.

⁹⁸ *See Triennial Review Order* at ¶ 677-78.

B. Depreciation Expense – TELRIC NPRM § IV.D.

ACS supports the Commission's recommendation in the *Triennial Review Order* that state commissions develop UNE rates based on an accelerated depreciation of assets to reflect any anticipated decline in value and to allow the carrier to compete with competitors that purchase new, lower-priced equipment in later years.⁹⁹ The Commission should not only reiterate this principle but also provide more clear direction to states that this approach is required to ensure proper UNE rates. Specifically, the Commission should explain what is meant by "accelerated depreciation" through examples or other guidance. In the Anchorage rate proceeding, GCI has argued that in some cases where equipment costs are rising, depreciation should be decelerated.¹⁰⁰ However, this is contrary to the realities of a competitive market where the CLEC eventually will move customers to its own facilities. If depreciation of assets is decelerated, as facilities-based competition grows, the ILEC will be unable to recover a larger portion of its equipment costs.

The Commission correctly reasoned in the *Verizon Virginia Arbitration Order*, that even if there is no new entry, but the cost of an asset is continuously decreasing, an ILEC would not recover the initial capital outlay for the asset if regulators at each rate proceeding establish successively lower UNE prices based on the application of straight line depreciation to lower asset prices.¹⁰¹ Allowing states discretion on whether to apply this principle could only

⁹⁹ *Triennial Review Order* at ¶ 690.

¹⁰⁰ Testimony of Michael J. Majoros on Behalf of General Communication Inc., Before the Regulatory Commission of Alaska, *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-95-89, Public Hearing, Volume XII at 1393-4 (Nov. 10, 2003) ("Majoros Testimony").

¹⁰¹ *Verizon Virginia Arbitration Order* at ¶ 94.

result in forward-looking UNE rates that are unrealistic and inconsistent with the competitive reality resulting in the market from the ILEC's unbundling obligations.

In addition, the Commission should mandate the use of shorter asset lives to account for competitive risks. In the *Triennial Review Order*, the Commission declined to adopt any particular set of economic lives.¹⁰² However, shorter asset lives also account for the increase in the rate of future technology changes in a forward-looking environment. Further, shorter service lives are appropriate in competitive markets; assuming that CLECs eventually move their customers to their own facilities, as contemplated by the purpose of the Act and the rules, the ILEC's facilities will be left stranded. Unless future ratepayers pay more in depreciation per unit than current ratepayers, ILECs will be unable to recover the cost of the network. Thus, state commissions should be required to consider any plans of CLECs in the market to deploy facilities in the near future.

¹⁰² *Triennial Review Order* at ¶ 688.

C. Expense Factors – TELRIC NPRM § IV.E.

In order to develop more realistic forward-looking cost inputs for operations and maintenance expenses, state commission should determine these costs separately from construction costs. Many cost models, including the Synthesis Model, assume that operations and maintenance costs move in concert with construction costs. However, this assumption is invalid; in reality, even when construction costs decrease, there are not necessarily corresponding efficiencies in operations and maintenance.

Likewise, overhead expenses, including corporate operations expense, should reflect the ILEC's actual experience. This cost input is largely a labor-driven expense. As indicated above, labor costs generally trend upward.¹⁰³ Further, the level of efficiency that is assumed in developing a forward-looking overhead expense input should be realistic for the ILEC and the market in question. For instance, in the Anchorage rate proceeding, GCI proposed a corporate operations expense of \$0.66, while ACS proposed about \$8.00 based on its actual experience.¹⁰⁴ GCI's proposal is based on an assumption regarding efficiency that no carrier in Anchorage could ever achieve. States should not arbitrarily reduce costs in reliance on notions of efficiency that are unachievable in the market. Doing so will distort the entry decisions of competitors and undermine the goals of TELRIC pricing.

In order to limit the range of proposed cost inputs, the Commission should instruct states that forward-looking corporate operations expense must be in a reasonable range

¹⁰³ Prefiled Reply Testimony of William J. Wilks on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89 at 8-9 (filed Oct. 13, 2003) ("Wilks Prefiled Reply Testimony").

¹⁰⁴ Prefiled Opposition Testimony of David C. Blessing on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89 at 18-19 (filed Sept. 29, 2003).

above or below the cap developed for USF purposes. For USF purposes, the corporate operations expense input has been capped as a percentage of total expenses in order to limit high-cost support allocated toward this expense.¹⁰⁵ The Commission's reasoning for this cap was that it would encourage rate of return carriers to be more efficient in incurring them. However, in a market such as Anchorage, ACS must be efficient in order to remain competitive with a GCI, which has almost 50 percent of the market share. Nonetheless, ACS asks that some limit be imposed to prevent the type of proposals set forth by GCI that are based on unreasonable efficiency assumptions.

¹⁰⁵ 47 C.F.R. § 36.631.

D. Non-Recurring Charges – TELRIC NPRM § IV.F.

ACS requests that the Commission clarify that non-recurring charges (“NRCs”) should reflect the actual costs of the ILEC. For instance, states should not make unrealistic assumptions about the ILEC’s network technologies and capabilities. In Fairbanks and Juneau, the RCA has made unrealistic assumptions about ACS’s provisioning systems, which has resulted in provisioning costs that are less than a tenth of the real cost to ACS of provisioning service to competitors. State commissions should not assume changes to the ILEC’s network that have not actually been made (because such changes would be inefficient), solely to lower the cost to the CLEC. Such unrealistic assumptions will encourage uneconomic entry by CLECs.

Further, any costs incurred exclusively for the benefit of the CLEC ordering the UNE may be recovered by the ILEC through a NRC. Costs for service orders, and premises visits, for example, should be recovered based on costs actually incurred. GCI has argued that these costs are included in existing components of the UNE rate and that there should be no additional cost for NRCs. Under this approach, however, the ILEC would never recover such costs because GCI’s proposed approach also assumes that all ordering and provisioning would be automated in the future and that there would be no labor costs associated with provisioning UNEs.

As discussed above, the Commission should clarify that ILECs may recover non-recurring costs over a shorter timeframe in a market where there is significant competition and CLECs are likely to move customers to their own facilities. If a longer period is used, ILECs will be unable to recover their costs once its facilities have been left stranded.

VIII. RATE CHANGES OVER TIME – TELRIC NPRM § IV.I.

ACS disagrees with the Commission's proposal to put in place a mechanism that would automatically adjust UNE rates over time.¹⁰⁶ The purpose of TELRIC is to replicate market-based rates arising in a competitive environment. As ACS has noted above, rates based on forward-looking costs are necessarily predictive and cannot be determined with certainty. The recommendations that ACS makes in these comments are designed to produce predictions that are reasonably based in costs that are likely to reflect the circumstances in a particular market as competition evolves there. Applying an adjustment factor to rates that are based on predicted costs could instead have the effect of skewing errors in rate determinations. Further, such correction factors give the illusion of precision, when in actuality, an automatic adjustment magnifies the hypothetical nature of the rates.¹⁰⁷

Instead, state commissions should be directed to revisit TELRIC rates every three years. In this manner, rates can be adjusted to reflect actual market conditions as competition in the market evolves. In the TELRIC NPRM, the Commission noted that a typical UNE pricing proceeding may take two or three years to complete, which results in rates that may be outdated at the time they are adopted.¹⁰⁸ In Anchorage, the RCA opened a proceeding to arbitrate UNE rates in 1996 and has yet to establish TELRIC-based rates. As a result, ACS has been charging the same, below-cost UNE prices for over seven years. ACS knows all too well the delays that

¹⁰⁶ See TELRIC NPRM at ¶ 139.

¹⁰⁷ ACS disagrees with the proposal in the OSP Working Paper by David M. Mandy and William W. Sharkey to impose a correction factor to adjust UNE rates over time. See David M. Mandy et al., *Dynamic Pricing and Investment from Static Proxy Models*, OSP Working Paper No. 40 at 20-23 (Sept. 2003). The adjustment factor does not account for any stranded investment of the ILEC. Once the CLEC moves its customers off of the ILEC's network, the correction factor for rates cannot provide for recovery of costs.

¹⁰⁸ TELRIC NPRM at ¶ 138.

can arise from the state commission's implementation of the open-ended TELRIC rules. ACS believes that if the Commission adopts the limits on state discretion that ACS proposes in these comments, review of UNE rates after a three year period would be feasible.¹⁰⁹ Only through periodic review of UNE rates can state commissions update prices to reflect adequately changes in costs, increases in risk and the emergence of successful competition.

¹⁰⁹ As discussed elsewhere in these comments, if the Commission does not adopt the types of guidelines that ACS proposes in these comments, states should be required to review due to the greater potential for rates that are not based on the ILEC's costs to have a confiscatory effect. Further, arbitrating parties should always be allowed to agree upon a different time period for state review of UNE rates.

IX. RESALE PRICING – TELRIC NPRM § V

In accordance with the directive of the Eighth Circuit Court of Appeals, the Commission should amend its resale pricing rules to clarify that the wholesale discount must only reflect *avoided* costs – costs that the ILEC will actually avoid in the future, rather than all “avoidable” costs.¹¹⁰ Specifically, the Commission should refine the standard for “actually avoided costs.” Instead of a presumption that certain categories of costs are avoided or avoidable when the ILEC’s customer is captured by a competitive resale provider, the Commission should direct states to determine which categories of costs are actually avoided, and which costs increase.

In ACS’s experience, the current presumption that marketing, billing and collection costs are wholly avoided is inaccurate. ACS’s has found that only 8-10% of the costs of serving the customer are avoided when the customer is captured by the reseller.¹¹¹ For customers served by competitors through resale, customer service costs and some billing costs are avoided; however, fixed costs relating to billing and collection are distributed over a smaller pool of customers, and thus are not avoided. Additionally, in a competitive environment, certain costs of the ILEC will increase, such as marketing, legal and regulatory costs. Without examining the ILEC’s actual experience, the state commissions cannot adequately determine which costs are truly avoided.

¹¹⁰ TELRIC NPRM at ¶ 142.

¹¹¹ See Prefiled Direct Testimony of Heather M. Eldred on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89 at 13 (filed Aug. 29, 2003).

X. IMPLEMENTATION ISSUES – TELRIC NPRM § VII

ACS urges the Commission to issue specific guidelines for states to follow in developing forward-looking cost based rates that will minimize the cost and burdens associated with TELRIC rate proceedings. Many of ACS's recommendations would limit proposed cost inputs to a certain range, and hopefully will avoid the submission of an impossibly wide range of UNE loop rates such as have been proposed by ACS and GCI in rate proceedings in Alaska. The uncertainty regarding the proper implementation of TELRIC has contributed to the extensive delay in concluding UNE rate proceedings. For instance, in Anchorage, the RCA has been arbitrating UNE rates between ACS and GCI since the Act was adopted but has yet to establish forward-looking UNE rates. Many of the cost input assumptions are bitterly disputed by both sides due to the lack of guidance in the rules.

By narrowing the range of the state commissions' discretion in applying TELRIC and by placing reasonable limits on discovery in connection with ratemaking proceedings, the ratemaking process can be streamlined and can allow for periodic review and adjustment of UNE rates every three years, as ACS proposes in these comments. During such review, the state commission should make any necessary adjustments to UNE rates to ensure that competitors are receiving appropriate market entry signals. The level of guidance provided by the current TELRIC rates necessitate more frequent state review due to the excessive opportunity for such rates to have a confiscatory effect and the lack of procedures for review of confiscatory rates. If the Commission does not adopt the type of explicit guidelines proposed by ACS in these comments, the Commission should require state commissions to revisit UNE rates every two years, or a different time period upon which the arbitrating parties have agreed.

ACS agrees with the Commission's suggestion that any new rules and guidance on TELRIC rates be implemented by state commissions within nine months of the effectiveness of the order.¹¹² ACS urges the Commission to place reasonable limits on the duration of UNE rate proceedings in order to prevent the undue delays that have resulted in Alaska. Additionally, ACS requests that the Commission clarify that the same nine-month period for completing the arbitration of initial interconnection agreements, as provided in Section 252(b)(4) of the Act,¹¹³ also applies to the arbitration of any subsequent agreement. In Anchorage, the RCA has never established forward-looking cost-based rates even though a ratemaking proceeding has been ongoing for the last seven years. In order to avoid such results, the Commission should explicitly mandate that the arbitration of subsequent interconnection agreements be resolved within nine months of the date of the request for arbitration. Alternatively, interconnection agreements could contain a self-executing provision for renegotiation or arbitration of rates within the nine-month timeframe preceding the expiration date of the current agreement.

¹¹² TELRIC NPRM at ¶ 150.

¹¹³ 47 U.S.C. § 252(b)(4).

XI. CONCLUSION

In this proceeding, ACS urges the Commission to provide a greater level of certainty to states on how to implement TELRIC in a manner that properly promotes the goals of the Commission's rules. Rates based on forward-looking costs that are reasonably based on actual costs that carriers can achieve in the market will send efficient entry and investment signals to CLECs and ILECs in the market.

ACS urges the Commission to consider carefully the impact of the currently open-ended TELRIC rules on the local exchange markets in Alaska. In ACS's markets, the artificially high levels of competition have discouraged CLECs from building their own facilities and have inhibited the ILEC's ability to invest in the network. The Commission should require states to consider the real-world attributes of the ILEC and the geographic market in which the network is located. Additionally, the Commission should impose a requirement that state commissions revisit rates generated using the type of guidelines ACS proposes in these comments every three years to make any adjustments necessary to promote investment in network facilities. ACS respectfully encourages the Commission to make this proceeding a priority and expedite the order in this docket to provide much needed guidance to carriers and regulators.

Respectfully submitted,

ALASKA COMMUNICATIONS SYSTEMS GROUP,
INC.

/s/ Karen Brinkmann

Leonard A. Steinberg
General Counsel
ALASKA COMMUNICATIONS SYSTEMS GROUP,
INC.
600 Telephone Avenue
Anchorage, AK 99503
(907) 297-3000

Karen Brinkmann
Elizabeth R. Park
LATHAM & WATKINS LLP
555 Eleventh Street, N.W.
Suite 1000
Washington, D.C. 20004-1304
(202) 637-2200

*Counsel for Alaska Communications
Systems Group, Inc.*

December 16, 2003